IV. SECTION 272 AFFILIATE SAFEGUARDS

A. THE PURPOSE OF SECTION 272

The break-up of the AT&T monopoly was driven by an anti-trust case in which the central allegation was that AT&T had treated its subsidiary companies in a manner that gave them preference over potential and actual competitors. Since the Act contemplates the reintegration of companies in the segments of the industry that had been separated by the Modified Final Judgement, it is not surprising that the Act contains a new section stipulating how seal-dealing would be handled.

Because the central concern is with the ability of the incumbent RBOCs to leverage their control over the monopoly local companies and disadvantage new entrant, the affiliate safeguards contained in the 1996 Act are extremely detailed in their prescriptions. Beyond the traditional structural separations and requirements for arms length transactions (section 272 (b), the 1996 Act states a series of specific requirements covering goods, services, facilities, information, and standards (section 272 (c). It goes on to stipulate non-discrimination in the length of time it requires to provide services, the terms, conditions, and charges for service, as well as cost allocation requirements (section 272 (e)).

B. BST AFFILIATE SAFEGUARDS ARE INADEQUATE

In its Application and supporting affidavits, BST promises to implement the required structural separations and accounting safeguards required by section 272, after its entry has been approved. This is another paper promise on which the Commission cannot rely in to ensure that

competitors will receive just, reasonable and nondiscriminatory treatment under the Act. BST asserts that it does not have to "conduct or report transactions in accordance with the requirements of section 272 prior to receiving interLATA authorization and establishing BSLD as a section 272 affiliate."[61] BellSouth witnesses present the ironic prospect of citing the 1996 Act as proof that discrimination cannot take place,[62] but this is the very proceeding to evaluate whether the law has been implemented properly. BST witnesses go on to argue that since the DOJ relies on regulatory and anti-trust safeguards in vertical merger transactions to prevent discrimination, it should rely similar approaches in the case of BOC entry into long distance,[63] but this is the proceeding in which those safeguards are to be defined. The DOJ has not found any set of safeguards offered by a BOC to be adequate. BST's are far from the best.

At the same time BST has not come anywhere near meeting the conditions that the FCC laid out in the Ameritech-Michigan proceeding.

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[61]BST Application, p. 76.

[62]Gilbert, p. 22, argues

> The safeguards of the 1996 Act ensure that BOC interexchange entry will not result in discrimination by requiring, among other conditions, that:
>
> - o The BOC may not discriminate between its interLATA affiliate and any other entity in the provision or procurement of goods, services facilities, and information, or in the establishment of standards; and shall account for all transactions with an affiliate in accordance with accounting principles designated or approved by the Commission...
>
> For example, according to the 1996 Act, BellSouth must offer to IXC competitors, on the same terms and conditions, any intraLATA facilities used by its interLATA affiliate.

[63]Gilbert, pp. 22-23, argues

> The effectiveness of antitrust and regulatory safeguards in preventing discrimination is demonstrated by the Department of Justice's continued use of such safeguards in vertical transactions which raise issues similar to those of BOC interLATA authority.

Where BST witnesses seem to recognize that this is the proceeding where the existence of barriers to entry is to be assessed and mechanisms to ensure their removal to be put in place, they urge the commission to let RBOCs in, even if barriers to entry have not been entirely removed.[64]

Guided by its belief that it does not have to follow Commission guidelines, it has established these affiliate companies and begun making extensive preparations for entry into long distance. BST has begun providing services to BellSouth Long Distance (its affiliated long distance company). Many of the services it is providing to its affiliate involve exactly the points on the competitive check list which are subject to the greatest contention in the state proceedings and raise the greatest concern at the Department of Justice.

For example, the following questions arise in the transactions which BST has admitted conducting between the long distance affiliate and the parent, or one of its subsidiaries.

Billing and collection.

> Has BST provided interfaces or information dealing with interfaces for BSLD which are different than the interfaces and information which has been made available to non-affiliated entities?
>
> Will BST terminate current contracts with interexchange carriers?

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[64]Hausmann, p. 6, tells the commission to ignore remaining barriers to entry if they are "small."

> If all significant barriers to local entry have been removed, the Commission should permit BOC entry into long distance markets.a/ However, even if say 95% of the barriers to entry had been eliminated and 5% remained, it would not be in the consumers' best interest to forgo the billions of dollars of consumers benefits from long distance competition to achieve the last 5% of entry barrier removal.
>
> a/ By significant barriers to entry, I mean barriers to entry that would allow a BOC to charge supra competitive prices.
>
> If leaving 5% of the barriers allows BOCs to raise prices by 5 percent, then the cost to the public would be four times greater than a reasonable estimate of benefits of BOC entry into long distance. Moreover, the hypothetical does not apply to the case of BST, where there are a lot more than 5 percent of the barriers remaining.

Has BST provided information that facilitates the development, design, coding and testing of systems, including infrastructure changes to bill long distance customers, which in any way is superior to the information and assistance provided to non-affiliated entities?

Sales Channel Planning and Design:

Has BST provided information or assistance in the development of specification for taking orders, handling of customer inquires, credit policies, adjustment procedures, testing of sales and billing procedures, and training of service representative that is in any way superior to that offered to non-affiliated providers?

Product integration:

Has BST provided or tested interfaces for product integration or ordering that are superior to the information offered to non-affiliates?

Collocation space.

Has physical collocation been easier for BSLD than non-affiliated companies?

BST has refused to put in place the benchmarks and performance standards by which the FCC would answer these questions. To allow BST to conduct transaction unpoliced until the moment of entry and then begin a process of tracking down transactions would be a nightmare for authorities charged with ensuring nondiscrimination between affiliates and competitors. The Section 272 affiliate could arrive on the scene endowed with a host of advantages conferred on it in its unregulated period. The legacy of discrimination would be beyond the power of the FCC to address.

The Department of Justice has recognized that post-entry policing of anti-competitive behaviors is extremely difficult.

> As a general matter, exclusive reliance on policing conduct and on undoing competitive damage ex post is problematic; this is why, for example, antitrust merger policy places such weight on preventing anti-competitive mergers rather than allowing all mergers and attempting to address anti-competitive conduct after the fact. In the present context, authorizing BOC entry prematurely and relying solely on post-entry safeguards to attempt to open BOC local markets to competition is especially dangerous.
>
> As my affidavit explained, many of the local competition arrangements required by the Act, such as wholesale support services and network unbundling, are novel and hence offer great scope for gaming and delay by incumbents...
>
> Therefore, there is real value in insisting that a BOC establish the main requisite new systems before being allowed entry. A BOC's own incentive to expedite interLATA entry will then induce it to implement these systems more efficiently and expeditiously than if entry were authorized and regulators had to then force the recalcitrant BOC to implement these systems.[65]

BST should be told to establish the affiliate subject to section 272, if it intends to use the affiliate after entry is granted.

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[65]Schwartz, Nov. 3, 1997, p. 17.

PART II:

ATTACHMENT 1:

LAST CHANCE FOR LOCAL COMPETITION:

SECTION 271 POLICIES TO OPEN LOCAL MARKETS

I. INTRODUCTION

A. A CRUCIAL DECISION

The issue in the section 271 proceedings is simple.[21]

> Have the Baby Bells loosened their hold on their hundred year old monopoly over local telephone service enough to ensure that competition in local service will benefit consumers and provide for fair competition in long distance markets?

Consumers have a huge stake in the answer to this question. Not only do they spend over $150 billion per year on telecommunications services, but the telecommunications network is the on-ramp for the information superhighway. Open competitive access to information services will be crucial to determining political, social and economic opportunities in the 21st century.

The purpose of this paper is to present a comprehensive consumer view of the entry of RBOCs into in-region, interLATA long distance. It relies entirely on the observation of third parties about the legal and economic conditions that have been placed on entry. That is, we ignore the special pleadings of the RBOCs, potential local service competitors, and the long

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[21] As of late September 1997, there have been two requests for entry into long distance. Ameritech has tried to enter in Michigan twice. All references to Michigan in this part refer to the initial applications (Michigan Public Service Commission, In the Matter of the Commission's Own Motion to Consider Ameritech Michigan's Compliance with the Competitive Check List in Section 271 of the Telecommunications Act of 1996, Case No. U-11104; Federal Communications Commission, In the Matter of Application by Ameritech Michigan to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Service in Michigan, CC Docket 97-1. References to the Federal Communications Commission action in response to the Michigan Request are to Federal Communications Commission, Memorandum Opinion and Order In the Matter of Application by Ameritech Michigan to Section 271 of the Telecommunications Act of 1934, as amended, to Provide In-Region, InterLATA Service in Michigan, CC Docket 97-13, August 19, 1997 (hereafter FCC Michigan). SBC has tried to enter in Oklahoma (Oklahoma Corporation Commission, Cause NO. PUD 97-64) Federal Communications Commission, In the Matter of Application of SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Oklahoma, CC Docket No. 97-121. As has become the norm in the implementation of the Telecommunications Act of 1996, there are also two court cases, one for each of the FCC decisions.

distance industry. Instead we rely on the analyses of Attorneys General, Consumer Advocates, and Public Utility Commissions. In each section we discuss comments by various state agencies, the Department of Justice, and conclude with the FCC position, which will be dispositive of any request for entry into interLATA markets.

B. OUTLINE OF THE PAPER

The next chapter, Chapter II presents a brief explanation of the stakes for consumers. An assessment of the stakes plays an especially important role in this area. Because the decision about entry requires policy makers to strike a balance between potential competitive benefits in the local and long distance industries and potential anti-competitive behaviors, it is crucial for consumer commentors to quantify the stakes.

Chapter III describes the process outlined in the 1996 Act for the decision about RBOC entry into in-region, interLATA long distance. Under the Act, the RBOCs must seek authorization and show that they have satisfied the conditions established by Congress. Unfortunately, even the most basic questions of which issues can be raised have become a bone of contention.

Finally, the comments present a discussion of each of the four major steps in deciding whether or not RBOCs should be allowed to sell in-region long distance. Chapter IV reviews the requirement for the presence of facilities-based competition prior to entry of RBOCs into in-region long distance. Chapter V then reviews the competitive check list items that must be provided by RBOCs. Chapter VI turns to the safeguards for affiliate transactions that must be in place. Chapter VII discusses the broad public interest standards that must be applied.

II. THE CONSUMER INTEREST IN EFFECTIVE COMPETITION IN TELECOMMUNICATIONS MARKETS

A. THE CENTRAL PUBLIC POLICY ISSUE

The Department of Justice has succinctly summarized the public policy balance that Congress struck in the 1996 Act when it addressed the issue of RBOC entry into in-region long distance.

> InterLATA markets remain highly concentrated and imperfectly competitive, however, and it is reasonable to conclude that additional entry, particularly by firms with the competitive assets of the BOCs, is likely to provide additional competitive benefits.
>
> But Section 271 reflects Congressional judgements about the importance of opening local telecommunications markets to competition as well. The incumbent local exchange carriers (LECs), broadly viewed, still have virtual monopolies in local exchange service and switched access, and dominate other local markets as well. Taken together, the BOCs have some three-quarters of all local revenues nationwide, and their revenues in their local markets are twice as large as the net interLATA market revenues in their service areas. Accordingly, more considerable benefits could be realized by fully opening the local market to competition.[22]

In short, Congress recognized that opening the local monopoly to competition was far more important than adding more competition in the long distance market.

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[22] "Evaluation of the United States Department of Justice, Federal Communications Commission, In the Matter of Application of SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Oklahoma, CC Docket No. 97-121, May 16, 1997 (hereafter, DOJ, SBC), p. 4.

B. ECONOMIC IMPORTANCE OF COMPETITIVE REFORM IN TELECOMMUNICATIONS MARKET

A quick look at the numbers reinforces the fundamental observation that there is a lot more at stake for consumers in the local market (see Table 1).

- o The local market is approximately twice as large as the long distance market.
- o The level of concentration in the local market is about three times as high.
- o RBOCs have excessive rates of profit.
- o Potential consumer savings resulting from the introduction of competition into the local market is close to $10, several orders of magnitude greater than potential savings in long distance.

Consumers spend over $90 billion on local service, compared to about $50 billion in long distance. This does not include yellow pages and other unregulated activities of the LECs. It excludes cellular revenues for both LECs and IXCs.

The Department of Justice estimates that the current long distance market is a highly concentrated market, as measured by the Hirschman Herfindahl Index (HHI). The Department of Justice uses an HHI of 1800 as the point at which it considers a market highly concentrated (see Appendix B for a description of the meaning of these concentration measures). DOJ considers an HHI of 1000 to identify a moderately concentrated market. With an HHI of 3200, the long distance market is far above the threshold for a highly concentrated market.

TABLE 1
CHARACTERISTICS OF THE LOCAL EXCHANGE AND
LONG DISTANCE INDUSTRIES

	LONG DISTANCE	LOCAL
	a/	a/
REVENUE ($, billion)	50	93
	b/	c/
CONCENTRATION (Hirshman Herfindahl Index)	3200	9200
	d/	
RETURN ON EQUITY (1994-1996)	14.8	23.3
	e/	
EXCESS PROFITS ($, billions, Including Tax Effects)	0-2	8-12

a/ "Affidavit of Marius Schwartz," Evaluation of the United States Department of Justice, In the Matter of Application of SBC Communications Inc. Et.al. Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in the State of Oklahoma, CC Docket NO. 97-121, May 16, 1997, Table 1.

b/ Evaluation of the United States Department of Justice, In the Matter of Application of SBC Communications Inc. Et.al. Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in the State of Oklahoma, CC Docket NO. 97-121, May 16, 1997.

c/ "Affidavit of Marius Schwartz," Evaluation of the United States Department of Justice, In the Matter of Application of SBC Communications Inc. Et.al. Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in the State of Oklahoma, CC Docket NO. 97-121, May 16, 1997, Table 1. Excludes miscellaneous revenues. Assumes CAP, CLEC and IntraLATA long distance revenues as the competitors' market share.

d/ "Performance Ranking of the S&P 500," Business Week, March 24, 1995

e/ See appendix A.

However, the local market is even more concentrated. Using national figures for revenues earned by competitive access providers (CAPs) and competitive local exchange companies (CLECs), as well as intraLATA long distance competition, we conclude that incumbent LECs have a 96 percent market share.[23] This yields a HHI index of 9200, almost three times that of the long distance market. Calculating concentration on a state-by-state basis, using the data provided in the Section 271 filings of both Ameritech (Michigan) and SBC (Oklahoma) the results would show an even more highly concentrated market. The market share of the LECs is still 99 percent.

Reflecting the different levels of competition in the two industry segments, we observe a much higher level of profitability in the LEC segment. In 1994-1996 period, the large LECs (the seven Baby Bells plus GTE) earned an average return on equity of over 23 percent. This was well above the national average for large firms of about 16 percent. Over the same period, the three largest firms in the long distance industry earned a return on equity of about 15 percent, somewhat below the national average. While long distance profits have bounced around, local profits have consistently exceeded the national average and have been growing very rapidly.

Reflecting both the size of the two industry segments and the different levels of competition, the gains to consumers from an increase in competition in each is dramatically different. If competition were to drive return on equity down to the national average in both segments, consumers would see benefits that are at least four times as large in the local service market. Vigorous competition would lower prices charged for local service by between $8 billion and $12 billion. In long distance there appears to be at most $2 billion of excesses that could be

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[23] The market share for residential customers is well over 99 percent. As measured by lines, the market share of LECs is above 96 percent.

squeezed out.[24] There is just a lot more fat to be squeezed out through local competition.

C. PUBLIC POLICIES TO SECURE COMPETITION

Reflecting the more highly developed level of competition in the long distance industry segment and the fact that local exchange markets are a bottleneck input for long distance markets, Congress placed its emphasis on ensuring that local markets would be competitive. While the long distance oligopoly could be expected to perform better if greater competitive forces were brought to bear in it, the crucial barrier to competition in the telecommunications industry is the local monopoly.

> Section 271 reflects Congress' recognition that the BOCs' cooperation would be necessary, at least in the short run, to the development of meaningful local exchange competition, and that so long as a BOC continued to control local exchange markets, it would have the natural economic incentive to withhold such cooperation and to discriminate against it competitors. Accordingly, Congress conditioned BOC entry on completion of a variety of steps designed to facilitate entry and foster competition in local markets.[25]

The FCC took the opportunity of its first 271 decision to outline in detail the competitive advantage the local companies have in entering the long distance market compared to other companies entering the local market.

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[24] It has been widely noted that the local companies that have been allowed to enter into long distance have not competed vigorously on price (See Bear Stearns, Telecommunications Services, July 30, 1996; Merrill Lynch, Telecommunications Services, 14 May, 1996; J.P. Morgan, Telecommunications Review, July 16, 1996). The FCC Michigan notes this as well (para. 15).

> The recent successes of Southern New England telecommunications Corp. and GTE in attracting customers for their long distance services illustrates the ability of local carriers to garner a significant share of the long distance market.

[25] DOJ, SBC, pp. 4-6.

The most crucial observation is to recognize, as the Antitrust court had,[26] the power inherent in the incumbent monopoly status of the local exchange companies. These advantages include[27]

a history of legal barriers,

economic and operational barriers,

the fully deployed, ubiquitous network of the incumbents which lowers their incremental cost of entering other markets, and

the need for interconnection.

Not only do the incumbent local exchange companies have an advantage in the market

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[26] FCC Michigan, para 10.

> The court found that, if the BOCs were permitted to compete in the interexchange market, they would have "substantial incentives" and opportunity, through their control of local exchange and exchange access facilities and services, to discriminate against their interchange rivals and to cross subsidize their inter-exchange ventures...

[27] FCC Michigan, paras. 11...12.

> For many years the provision of local exchange service was even more effectively cordoned off from competition then the long distance market. Regulators viewed local telecommunications markets as natural monopolies, and local telephone companies, the BOCs and other incumbent local exchange carriers, often held exclusive franchises to serve their territories. Moreover, even where competitors legally could enter local telecommunications markets, economic and operational barriers to entry effectively precluded such forays to any substantial degree...
>
> These economic and operational barriers largely are the result of the historical development of the local exchange markets and the economics of local networks. An incumbent LEC's ubiquitous network, financed over the years by the returns on investment under rate of return regulation, enables an incumbent LEC to serve new customers at a much lower incremental cost than a facilities based entrant that must install its own network components. Additionally, Congress recognized that duplicating the incumbents local networks on a ubiquitous scale would be enormously expensive. It also recognized that no competitor could provide a viable, broad-based local telecommunications service without inter-connecting with the incumbent LEC in order to complete calls to subscribers served by the incumbent LECs network.

power they posses in the local market, but entry into the long distance market will be relatively easy for them because of the more competitive structure of that market.[28] The ease of entry stems from a number of factors including

brand recognition,

a fully deployed network, and

a mature market where switching and resale are common.

With this understanding of the advantages of the incumbents, the provisions of section 271 seek to redress the imbalance of market power between local companies and their potential competitors. The FCC notes that it was this competitive imbalance that Congress sought to

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[28] FCC Michigan, para 15...17.

> Indeed given the BOCs strong brand recognition and other significant advantages from incumbency, advantages that will particularly redound in the broad-based provision of bundled local and long distance services, we expect that the BOCs will be formidable competitor's in the long distance market and, in particular, in the market will bundled local and long distance services. ...
>
> Significantly, however, the 1996 act seeks not merely to enhance competition in the long distance market but also to introduce competition to local telecommunications markets. Many of the new entrants, including the major inter-exchange carriers, and the BOC, should they enter each other's territories, enjoy significant advantages that make them potentially formidable local exchange competitor hours. Unlike BOC entry into long distance, however, the competing carriers entry into the local market is handicapped by the unique circumstance that their success in competing for BOC customers depends upon the BOCs' cooperation. Moreover BOCs will have access to a mature, vibrant market in the resale of long distance capacity that will facilitate their rapid entry into long distance and consequently their provision of bundled long distance and local service. Additionally, switching customers from one long distance company to another is now a time tested, quick, efficient, and inexpensive process. New entrants into the local market, on the other hand, do not have available a ready, mature market for the resale of local service or for the purchase of unbundled network elements, and the process for switching customers for local service from the incumbent to the new entrant are novel, complex and still largely untested. For these reasons, BOC entry into long distance market is likely to be much easier than entry by potential BOC competitors into the local market, a factor that may work to BOC advantage in competing to provide bundled service.

address in Section 271.

> By requiring BOC to demonstrate that they have opened their local markets to competition before they are authorized to enter into the in-region long distance market, the 1996 act enhances competition in both the local am long distance markets.
>
> If the local market is not open to competition, the incumbent will not face serious competitive pressure from new entrants, such as the major interexchange carriers. In other words, the situation would be largely unchanged from what prevailed before the 1996 act. That is why we must ensure that, as required by the Act, a BOC as fully complied with the competitive checklist. Through the competitive checklist and the other requirements of section 271, Congress has prescribed a mechanism by which the BOC may enter the in-region long distance market. This mechanism replaces the structural approach that was contained in the MFJ by which BOCs were precluded from participating in that market.[29]

It is because of the clear advantages that incumbent local exchange companies possess and the failure of other sections of the 1996 Act to produce even a hint of competition that we believe the section 271 proceedings are the last chance for local competition. Without section 271, there was little in the Act to give the BOCs incentives to open their markets.[30]

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[29] FCC Michigan, paras 15...18.

[30] FCC Michigan, para 14.

> A salient feature of these market opening provisions is that a competitor's success in capturing local market share from the BOCs is dependent, to a significant degree, upon the BOCs' cooperation in the non-discriminatory provision of interconnection, unbundled network elements and resold services pursuant to the pricing standards established in the statute. Because the BOCs, however, have little, if any, incentive to assist new entrant in their efforts to secure a share of the BOCs' markets, the Communications Act contains various measures to provide this incentive, including section 271. Through this statutory provisions, Congress required BOCs to demonstrate that they have opened their local telecommunications markets to competition before they are authorized to provide in-regions long distance services. Section 271 creates a critically important incentive for BOCs to cooperate in introducing competition in their historically monopoly local telecommunications markets

III. THE PROCESS OF INTRODUCING COMPETITION INTO LOCAL MARKETS

In the 1996 Act Congress set a broad goal of "opening all telecommunications markets to competition." It recognized that different markets posed different problems. Because local markets would be particularly difficult, it imposed special conditions on local service companies. In sections 251 and 252 of the 1996 Act, it imposed a series of requirements on all local exchange companies, as well as specific requirements on incumbent local exchange companies.

Having identified the basic conditions for local competition, the Congress turned to the question of entry by RBOCs into in-region long, interLATA distance. Unsatisfied that the general requirements placed on the RBOCs to open their networks to competition would be effective, the Congress required additional conditions and oversight by other agencies before the RBOCs would be allowed to sell in-region long distance (see Table 2). The Congress required the FCC to make findings in four areas before RBOCs were to be allowed into in-region long distances. These findings were to be made in consultation with the states and the Department of Justice (whose advice was to be given substantial weight).[31]

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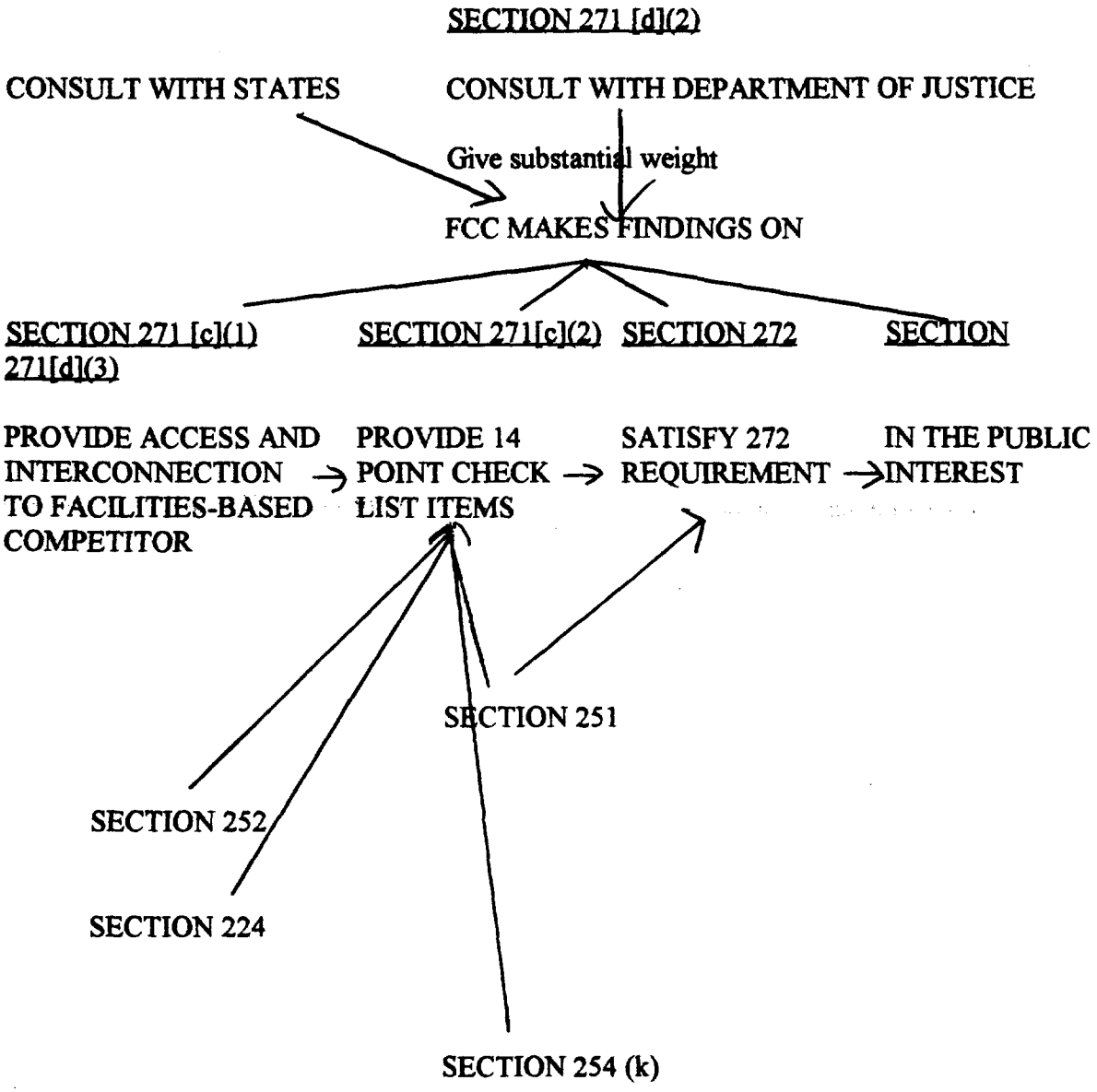
[31] DOJ, SBC, pp. 7-8.

Section 271 establishes four basic requirements for long distance entry. The first three such requirements -- satisfaction of Section 271 [c] (1) (A) (Track A) or Section 271 [c](1)(B)(Track B), the competitive check list, and Section 272 -- establish specific, minimum criteria that a BOC must satisfy in all cases before an application may be granted. In addition, Congress imposed a fourth requirement, calling for the exercise of discretion of the Department of Justice and the Commission. The Department is to perform competitive evaluation of the application. "Using any standard the Attorney General considers appropriate." And, in order to approve the application, the Commission must find that "the requested authorization is consisted with the public interest. In reaching its conclusion on a particular application, the Commission is required to give "substantial weight to the Attorney General's evaluation."

TABLE 2
PROCESS FOR APPROVING RBOC ENTRY INTO
IN-REGION, INTERLATA LONG DISTANCE



The exhaustive, detailed and overlapping requirements placed on the RBOCs and the multiple review by federal and state agencies with differing expertise make it clear that Congress intended a vigorous and rigorous regulatory process before RBOCs were to be authorized to sell in-region long distance. DOJ points out that Congress contemplated delay in RBOC entry.

> Congress carefully structured the four, interrelated prerequisites for BOC entry to ensure both (1) that the BOCs would have appropriate incentives to cooperate with competitors who wished to enter local markets and (2) the BOC entry into interLATA markets would not be held hostage indefinitely to the business decisions of the BOCs' competitors. Thus, rather than allowing for immediate entry or entry at a date certain, Congress chose to accept some delay in achieving the benefits of BOC interLATA entry in order to achieve the more important opening of local markets to competition.[32]

In section 271 [c](1) Congress required that there be a facilities-based competitor actually competing in the service territory of the RBOC for residential and business customers using predominantly its own facilities. Only under limited circumstances did Congress anticipate allowing RBOCs to sell long distance in region without being subject to facilities-based competition (See Table 3, Column 1).

In section 271 [c](2) Congress provided a more detailed list of specific actions that the RBOC had to take to open its network (see Table 3, Column 2). These referred back to the conditions identified in sections 251 and 252 and expanded on them in considerable detail. These conditions have come to be known as the 14 point check list, since there are 14 items on the list.

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[32] DOJ, SBC, p. 7.

TABLE 3
SUBSTANTIVE CONDITIONS FOR APPROVING RBOC ENTRY INTO IN-REGION, INTERLATA LONG DISTANCE

SECTION 271 [c](1)	SECTION 271[c](2)	SECTION 272	SECTION 271[d](3)
PROVIDE ACCESS AND INTERCONNECTION TO FACILITIES-BASED COMPETITOR	PROVIDE 14 POINT CHECK LIST ITEMS	SATISFY 272 REQUIREMENT	IN THE PUBLIC INTEREST
TRACK A OR TRACK B	FULL IMPLEMENTATION OF NON-DISCRIMINATION RATES, TERMS, CONDITIONS AND PROTECTIONS		
TRACK A: IS PROVIDING ACCESS AND INTERCONNECTION TO NETWORK FACILITIES FOR THE NETWORK FACILITIES OF ONE OR MORE UNAFFILIATED COMPETING PROVIDERS OF TELEPHONE EXCHANGE SERVICE TO COMPETITION RESIDENTIAL AND BUSINESS SUBSCRIBERS. STANDARD	INTERCONNECTION IN ACCORDANCE WITH SECTIONS 251 [C] (2) AND 251 [D](1) 1) NON DISCRIM, IN ACCORDANCE SECTION 251 [C](3) AND 251 [D](1) 2) NON-DISCRIM. ACCESS TO POLES 3) LOCAL LOOP 4) LOCAL TRANSPORT	SEPARATE AFFILIATE STRUCTURAL AND TRANSACTIONAL REQUIREMENTS NON-DISCRIM. SAFEGUARDS BIENNIAL AUDIT FULFILLMENT OF REQUESTS	PUBLIC INTEREST, CONVENIENCE AND NECESSITY COMPETITIVE TEST DANGEROUS PROBABILITY TO SUBSTANTIALLY IMPEDE VIII[C] TEST ANY OTHER SUBSTANTIAL
TRACK B: IF EVIDENCE NO SUCH PROVIDER HAS REQUESTED THE ACCESS & INTERCONNECTION IN TRACK A OR FAILED TO NEGOTIATE IN GOOD FAITH, UNDER SECTION 252 OR VIOLATED TERMS OF AN AGREEMENT UNDER SECTION 252 THEN: STATEMENT OF GENERALLY AVAILABLE TERMS APPROVED BY STATE COMMISSION	5) LOCAL LOOP 6) LOCAL SWITCH 7) NON-DISCRIM 11 & E911 DIRECTORY OPERATOR 8) WHITE PAGES 9) NON-DISCRIM. NUMBERING 10) NON-DISCRIM DATA BASES 11) INTERIM NUMBER PORTABILITY 12) NON-DISCRIM. LOCAL DIALING PARITY 13) RECIPROCAL COMPENSATION UNDER SECTION 252 [D](2) 14) RESALE UNDER SECTIONS 251[C](4) AND 252[D](2)	PROHIBITION ON JOINT MARKETING	OTHER FACTORS QUALITY CONSUMER PROTECT RATE STRUCTURE
CONTROVERSIES			
TRACK A REQUEST FORECLOSES TRACK B ANALYSIS PROVIDE ACCESS AND INTERCONNECTION APPROVED AGREEMENT PREDOMINANTLY FACITLIES-BASED BUSINESS AND RESIDENTIAL	FINAL RULES PERFORMANCE STDS FULLY LOADED FUNCTIONING MONITORING ENFORCEABLE	IMPLEMENTED MONITORED MEANINGFUL, NON-TRIVIAL, REAL, SUBSTANTIAL, IRREVERSIBLE COMPETITION	NATURE OF HEARING COMPETITION

Congress added requirements in section 272 for separation between the local and long distance arms of the RBOCs and regulation of affiliate transactions between local and long distance companies (see Table 3, Column 3). It also added safeguard to ensure that affiliates would not receive favorable treatment. These protections refer back to section 251 and expand and elaborate on them.

Finally, in section 271 [d] the Congress added a broad public interest finding to the decision making process (see Table 3, Column 4).

While some have complained about the heavily regulatory approach to review of requests for in-region sale of long distance,[33] even a quick review of the major areas in which Congress imposed conditions on RBOC entry into long distance suggests the careful scrutiny that Congress desired. The FCC argues that this structure was necessary to respond to an important public policy problem.

> Although Congress replaced the MFJ's structural approach, Congress nonetheless acknowledge the principles underlying that approach -- that BOC entry into long distance would be anti-competitive unless the BOC market power in the local market was first demonstrably eroded by eliminating barriers to local competition. This is clear from the structure of the statute which requires BOCs to prove that their markets are opened to competition before they are authorized to provide in-region long distance services. We acknowledge that requiring businesses to take steps to share their market is an unusual, arguably unprecedented act by Congress. But similarly, it is a rare step for Congress to overrule a consent decree, especially one that has forced major advances in technology, promoted competitive entry, and develop substantial capacity in the long distance market. Congress plainly intended this to be a serious step. In order to effectuate Congress' intent, we must make certain that the BOCs have taken real, significant and irreversible steps to open their market..
>
> The requirements of section 271 are neither punitive nor draconian. They reflect the historical development of the telecommunications industry and the economic

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33 Gassman, Lawrence, "The Telecommunications Act of 1996," Regulation, 1996

> realities of fostering true local competition so that all telecommunications of markets can be opened to be effective, sustained competition. Complying with the competitive checklist, ensuring that entry is consistent with the public interest, and meeting the other requirements of section 271 are realistic, necessary goals.[34]

Seeking to reduce or eliminate scrutiny of their requests, the RBOCs have attempted to minimize the requirements in each of these areas.[35] As a result a series of debates has taken place about the meaning of each of the conditions, as described at the bottom of Table 3. In the discussion that follows, we highlight the issues that have been disputed and the position taken by third parties representing consumer interests in each of these areas.

The FCC, the DOJ and the third party intervenors have insisted that the clear and distinct steps in the process be maintained. Each of the four tests constitutes a separate standard that must be met. The FCC's decision in the Ameritech Michigan application demonstrates a hierarchy of decision making, starting with section 271 (c)(1)(A),[36] working its way through each of the 14 points,[37] then the affiliate safeguards and finally the public interest standard.[38] At each

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[34] FCC Michigan, paras 18...23.

[35] They have done so in both the premature applications by Ameritech and SBC, but also in propounding general theories to interpret the law, see PacTel, Section 271 Guidebook, July 1996; Bell South, Statutory Avenues for Bell Operating Company Entry to the Long Distance Market, January 14, 1997.

[36] FCC Michigan, para .105.

> Because we have concluded that Ameritech satisfies section 271 © (1) (A), we must next determine whether Ameritech has fully implemented the competitive checklist in subsection © (2) (B).

[37] FCC Michigan, paras. 105...106.

> We conclude that Ameritech has not yet demonstrated by a preponderance of the evidence that it has fully implemented the competitive checklist. In particular, we find that Ameritech has not met its burden of showing that it meets the competitive checklist with respect to (1) access to its operations support system; (2) interconnection; and (3) access to

stage the intent of Congress and judicial construction of the concepts used in the statute must be applied.

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it 911 and E911 service. We do not decide whether Ameritech has met its burden of demonstrating compliance with the remaining items on the competitive checklist...

Given our finding that Ameritech has not yet demonstrated that it has fully implemented the competitive checklist, we need not decide in this order whether Ameritech is providing each and every checklist item at rates and on terms and conditions that comply with the Act.

[38] FCC Michigan, para. 42.

Although we do not reach the question of whether the authorization requested by Ameritech is consistent with the public interest, convenience, and necessity, the Department of Justice's examination of the state of local competition in Michigan is the type of analysis that we will find useful in its evaluation of future applications.

IV. FACILITIES BASED COMPETITION

A. DETERMINING WHICH PATH TO USE TO EVALUATE A REQUEST FOR ENTRY

The first condition that Congress imposed -- called Track A -- is the "Presence of a Facilities-Based Competitor." The requirement is that the RBOC "is providing access and interconnection to its network" under a "binding agreement" that has been "approved" with an "unaffiliated" competitor or competitors who are providing service to "residential and business subscribers" either "exclusively over their own telephone exchange service facilities or predominantly over their own telephone exchange service facilities in combination with the resale of the telecommunications services of another carrier."

The Congress provided for exceptions from the facilities-based requirement -- called Track B. The RBOC was not to be denied entry into in-region long distance only because facilities-based competitors were not trying very hard. Therefore, Congress allowed that RBOCs could be allowed entry without the presences of a facilities-based carrier under certain specific circumstances:

1) "if, after 10 months after the date of enactment no such provider has requested access and interconnection," or

2) after a request was made, the requesting party "failed to negotiate in good faith" or

3) after an agreement was made the competing local service provider "violated the terms of an approved agreement, by failing to comply "within a reasonable period of time, with the implementation schedule contained in such agreement."

In any of these cases, the RBOC could state general terms and conditions of

interconnection and move on to the next tests for entry.

The RBOCs have argued that if they have a request for interconnection under Track A which has not been implemented in a substantial way, they should be allowed to automatically move on to Track B, ten months after the passage of the Act.

The Department of Justice rejects SBC's interpretation, finding that it makes no sense given the clear words and intent of Congress.

> Having received requests for access and interconnection by qualifying potential facilities-based competitors, SBC cannot proceed under Track B.[39]
>
> But, contrary to SBC's contention, a BOC is not entitled to proceed under Track B simply because firms requesting interconnection and access for the purpose of providing services that would satisfy the requirements of Track A are not already providing those services at the time of the request. Such an interpretation of Section 271 would radically alter Congress' scheme, expanding Track B far beyond its purpose and, for all intents and purposes, reading the carefully crafted requirements of Track A out of the statute. Similarly, as discussed below, a requesting potential facilities-based carrier need not even have fulfilled all of Track A's requirements at the time of the BOC's Section 271 application to foreclose the BOC from proceeding under Track B, as congress understood that some time would be necessary before an agreement would be fully implemented and a provider could become operational.
>
> If SBC's interpretation of Track B were correct, Track B would no longer be a limited exception applicable where a BOC would otherwise be foreclosed indefinitely from entry into in-region interLATA markets. Rather, Track B would become the standard path, allowing BOCs to seek authorization to provide in-regional interLATA services even if not Section 252 agreement to.[40]

The Oklahoma Attorney General took the same point of view,[41] as did a group of thirteen

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[39] DOJ, SCB, p.vi.

[40] DOJ, SBC, pp. 13-14.

[41] AG Oklahoma, pp. 2-3.

> There is no evidence, no OCC certification, of such a provider's failure to negotiation in good faith or to comply with any implementation schedules. SBC's illogical